

# **Industry Working Group on Prevention of Money Laundering and Terrorist Financing**

## **Customer Due Diligence Process for Offshore Companies**

### **Preamble**

This paper provides guidance to authorized institutions (AIs) on issues relating to anti-money laundering (AML) and counter-terrorist financing (CFT). It has been developed by the User Sub-group on Customer Due Diligence Process (General) established under the auspices of the Industry Working Group on Prevention of Money Laundering and Terrorist Financing (IWG).

The IWG is convened by the Hong Kong Monetary Authority (HKMA) and comprises representatives of the Joint Financial Intelligence Unit (JFIU) and some twenty AIs in Hong Kong. Its mandate is to provide a forum for the exchange of views on topical AML/CFT issues, and to develop guidance to AIs on any such issues.

The practices recommended in this paper do not form part of the formal regulatory requirements of the HKMA. However, the HKMA considers that the adoption of these practices would strengthen an AI's systems and procedures for combating money laundering and terrorist financing. The HKMA therefore expects every AI to give full consideration to the adoption of these practices. In cases where the management of an AI decide not to follow the recommended practices, they should satisfy themselves that either the recommended practices are not applicable to their institution, or their institution has adopted alternative control measures which are equally effective and which enable their institution to fully comply with the HKMA's AML/CFT guidelines and circulars.

### **Introduction**

AIs are required under the HKMA's AML/CFT guidelines to put in place effective customer due diligence (CDD) procedures to identify the beneficial owners of their customers and verify their identity. The IWG notes that some AIs have encountered difficulties in complying with this requirement when they open accounts for offshore companies (i.e. companies incorporated in overseas jurisdictions). This paper introduces a set of industry standards, which would not only assist AIs in addressing these difficulties but also maintain a level playing field in the industry.

## Requirements of the HKMA

The HKMA's AML/CFT guidelines have laid down clear and specific requirements on AIs in opening accounts for corporate customers. Paragraph 5.11 of the Guideline on Prevention of Money Laundering (the Guideline) provides that:-

*“The following documents or information should be obtained in respect of corporate applicants for business which are registered in Hong Kong (comparable documents, preferably certified by qualified persons such as lawyers or accountants in the country of registration, should be obtained for those applicants which are not registered in Hong Kong) –*

- (a) Certificate of Incorporation and Business Registration Certificate;*
- (b) Memorandum and Articles of Association;*
- (c) Resolution of the board of directors to open an account and confer authority on those who will operate it; and*
- (d) A search of the file at Company Registry.” (emphasis added)*

Paragraph 4.5 of the Supplement to the Guideline (the Supplement) further states that:-

*“In relation to a company which is not listed on a recognised stock exchange (or is not a subsidiary of such a listed company) or not a state-owned enterprise or is a non-bank financial institution other than those mentioned above in paragraph 4.4, an AI should look behind the company to identify the beneficial owners and those who have control over the funds. This means that, in addition to obtaining the documents specified in paragraph 5.11 of the Guideline, the AI should verify the identity of all the principal shareholders, at least two directors (including the managing director) of the company and all its account signatories.” (emphasis added)*

Knowing that company laws and regulations vary from jurisdiction to jurisdiction, the HKMA has given some degree of flexibility to AIs in opening accounts for offshore companies. Specifically, Interpretative Notes No.16 (IN 16) provides that<sup>1</sup>:-

*“AIs may rely on the documentation provided by professional third parties (such as lawyers, notaries, actuaries, accountants and corporate secretarial service providers) in Hong Kong on behalf of a corporate customer incorporated in a country where company searches are not*

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<sup>1</sup> IN 15 is also relevant to offshore company accounts. However, its application is confined to high net worth individuals who use offshore investment vehicles as the contractual party to establish a private banking relationship with AIs.

*available, provided that there is no suspicion arising from other information collected and these professional third parties can meet the criteria set out in paragraphs 6.3 and 6.4 of the Supplement and IN 28 below.” (emphasis added)*

### Difficulties faced by AIs

As noted above, different jurisdictions may have different company formation requirements and documentation. In some jurisdictions such as British Virgin Islands (BVI) and Cayman Islands (Cayman), company search reports are not available. Instead, a Certificate of Incumbency (COI) (or equivalent) issued by a registered company service provider can be used to identify the directors and principal shareholders of a company. Nonetheless, where the company has multiple layers of ownership structure, information on the ultimate beneficial owner will not be provided in the COI. Moreover, in jurisdictions where both company search reports and COIs are not available, AIs are effectively left with no reliable means to identify and verify the ownership structure of a corporate customer other than obtaining a self-declaration from the directors of the company.

The IWG further observes that, although IN 16 permits AIs to rely on the documentation provided by professional third parties in Hong Kong to identify the beneficial owner of an offshore company, such professional third parties may not be able to confirm details of the ownership structure unless they were involved in the formation of the company or they are currently serving the company. Even if they were involved in the formation of such companies or are currently serving such companies, some of them may not satisfy the “fit and proper” criteria set out in paragraphs 6.3 and 6.4 of the Supplement.

### Proposed industry standards

Considering that the vast majority of offshore companies which maintain accounts in Hong Kong are from BVI or Cayman where COIs are available, the IWG proposes making it an industry practice that a COI should be obtained for corporate customers from BVI and Cayman, as well as other jurisdictions where COIs (or equivalent) are available (e.g. The Bermuda Islands, Gulf States and Belize), to open an account or otherwise establish a business relationship with the AI. Only COIs issued recently (i.e. those issued within 6 months) should be accepted by AIs for account opening. This proposal will create a level-playing field for all AIs and the cost of obtaining a COI will become a standard expense for all potential customers from these jurisdictions.

For companies with multiple layers of ownership structure<sup>2</sup>, AIs should, consistent with paragraph 4.6 of the Supplement, follow the chain of ownership to the individuals who are the ultimate principal beneficial owners of the direct customer and verify the identity of those individuals. To this end, AIs should consider obtaining additional independent and reliable documents (e.g. COIs) to gain a full understanding of the corporate structure. Alternatively, AIs may seek to meet with the directors or shareholders of the company and obtain a written declaration (Director/Shareholder Declaration) issued by them to confirm the ownership structure (in particular, the chain of ownership to the ultimate principal beneficial owners if the company has multiple layers of ownership structure) as well as other necessary details of the company. This latter approach should also be followed for companies from jurisdictions where both company search reports and COIs are not available.

In cases where a face-to-face meeting with the directors or shareholders of the company is not feasible (e.g. they are not in Hong Kong):-

- (i) AIs should obtain a Director/Shareholder Declaration showing chain of ownership to the ultimate principal beneficial owners plus arrange for a professional third party (such as lawyers, notaries, actuaries, accountants and corporate secretarial service providers) in the relevant jurisdiction to certify that information stated in the Director/Shareholder Declaration is correct and accurate;
- (ii) the account opening should be approved by a higher level of approval authority in the AI; and
- (iii) enhanced CDD should be conducted on the ultimate principal beneficial owners, and the account should be subject to on-going monitoring.

The above industry standards are summarised in the form of a process flow chart at the Annex.

For the avoidance of doubt, this set of industry standards should not be interpreted to override IN 15 and 16. AIs may continue to follow IN 15 in their dealings with high net worth individuals who use offshore investment vehicles as the contract party to establish private banking relationships. They may also rely on documentation provided by “fit and proper” professional third parties in their CDD process for offshore companies.

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<sup>2</sup> AIs are reminded that companies with an unduly complex structure of ownership for no good reason should be considered as high risk. AIs should exercise special care in dealing with such companies.

The IWG believes that the adoption of the above industry standards would strike an appropriate balance between the need to identify and verify the identity of beneficial owners on the one hand and enabling AIs to provide efficient banking services to offshore companies from different jurisdictions on the other. This is important to maintaining the status of Hong Kong as an international financial centre.

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